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COUNTIES: SUPREME COURT'S SUBSTANTIAL IMPACT  
ON AD VALOREM TAXATION

*County of Volusia v. State,*  
417 So. 2d 968 (Fla. 1982)

Appellant, Volusia County, sought circuit court validation<sup>1</sup> of a capital improvement bond issue to finance a new jail.<sup>2</sup> The county pledged all legally available, unencumbered sources of county revenue as security for the issue. Additionally, the appellant covenanted to fully maintain the existing programs and services that generated the revenues pledged.<sup>3</sup> The trial court denied validation, ruling the proposed bond issue violated article VII, section 12, of the Florida Constitution.<sup>4</sup> On direct appeal,<sup>5</sup> the Supreme Court of Florida affirmed and HELD, the constitution requires a referendum when the pledge securing revenues and the related covenants of a bond issue would have a substantial impact on future exercise of the county's ad valorem taxing power.<sup>6</sup>

The constitutional provision requiring referendum approval of local bonds<sup>7</sup> was principally adopted to prevent unreasonable taxation of real estate owners.<sup>8</sup> Furthering this legislative intent, the Florida Supreme Court has strictly scrutinized any form of contractual indebtedness that directly pledged the ad valorem taxing power.<sup>9</sup> In early validation cases, the court focused

1. FLA. STAT. §§ 75.01-.09 (1981). These sections provide that any county, municipality, or taxing district may determine its authority to incur bonded debt by filing a complaint in the appropriate circuit court. Upon review of all essential documents, the circuit court has jurisdiction to validate the issue. *Id.*

2. 417 So. 2d 968, 969 (Fla. 1982).

3. *Id.*

4. *Id.* FLA. CONST. art. VII, § 12 provides in pertinent part:

Counties, school districts, municipalities . . . may issue bonds, certificates of indebtedness or any form of tax anticipation certificates, payable from ad valorem taxation and maturing more than twelve months after issuance only:

(a) to finance or refinance capital projects authorized by law and only when approved by vote of the electors who are owners of freeholds therein not wholly exempt from taxation. . . .

5. FLA. CONST. art. V, § 3(b)(2) (1980) provides in part: "When provided by general law, [the supreme court] shall hear appeals from final judgments entered in proceedings for the validation of bonds or certificates of indebtedness. . . ."

6. 417 So. 2d at 972.

7. FLA. CONST. art. IX, § 6 (1930) provided: "[T]he counties, districts or municipalities of the State of Florida shall have power to issue bonds only after the same shall have been approved by a majority of the votes cast in an election in which a majority of the freeholders . . . shall participate. . . ." See FLA. CONST. art. VII, § 12 (1968) (quoted *supra* note 4).

8. *State v. City of Jacksonville*, 53 So. 2d 306, 308 (Fla. 1951). Other cases interpreting the original provision include: *State Bd. of Admin. v. Pasco County*, 156 Fla. 37, 40, 22 So. 2d 387, 390 (1945) (purpose of amendment was to impress local entities with financial responsibility); *Leon County v. State*, 122 Fla. 505, 514, 165 So. 666, 669 (1936) (provision's purpose was to lay restraint on spendthrift tendencies of political subdivisions).

9. See, e.g., *Kathleen Citrus Land Co. v. City of Lakeland*, 124 Fla. 659, 680, 169 So. 256, 265 (1936).

primarily on bondholder remedies in the event of default.<sup>10</sup> If the bondholder could ultimately compel a county or municipality to exercise its taxing power to discharge the obligation, the constitution required a referendum.<sup>11</sup>

In *State v. Halifax Hospital District*,<sup>12</sup> the Florida Supreme Court shifted its traditional focus from revenues pledged for bond repayment to revenues pledged for facility maintenance. The Hospital District requested validation of a bond issue pledging ad valorem taxes to the facility's operating fund.<sup>13</sup> The *Halifax* majority concluded that there was no substantive difference between pledging ad valorem tax revenues to operating expenses rather than to bond repayment.<sup>14</sup> Both pledges constituted obligations of the bond agreement.<sup>15</sup> Thus, the court held that any bond directly or indirectly pledging the taxing power required freeholder approval.<sup>16</sup>

The *Halifax* decision was based on two interrelated factors: the nature of the security issued and the covenants of the bond agreement.<sup>17</sup> As municipal financing techniques developed sophistication,<sup>18</sup> local governments started issuing bonds secured by numerous non-ad valorem sources of income.<sup>19</sup> In some cases, however, the pledging of these sources incidentally affected the future exercise of the taxing power. Consequently, the court expanded its analysis to encompass such bond issues.<sup>20</sup>

In the leading case of *Town of Medley v. State*,<sup>21</sup> appellant pledged specific

10. See, e.g., *Sunshine Constr. of Key West v. Board of Comm'rs, Monroe County*, 54 So. 2d 524, 526 (Fla. 1951).

11. See, e.g., *Broward Port Auth. v. State*, 129 Fla. 73, 85, 175 So. 796, 801 (1937) (a referendum is imperative because the local authority could be coerced into levying ad valorem taxes when a mortgage was pledged as bond collateral); *Boykin v. Town of River Junction*, 121 Fla. 902, 908-09, 164 So. 558, 560-61 (1935) (possibility of mortgage foreclosure on a physical plant pledged as bond security might compel the exercise of taxing power).

12. 159 So. 2d 231 (Fla. 1963).

13. *Id.* at 231-32. The authorizing resolution pledged the hospital's gross revenues as collateral for bond repayment. The resolution also agreed that the currently assessed ad valorem tax levy for hospital maintenance and operation would not be reduced during the life of the bonds and would be deposited in the operating fund. *Id.*

14. *Id.* at 233.

15. *Id.* The court found the obligation to make bond repayments and the commitment of ad valorem taxes so "clearly inter-dependent" that it could not separate the two pledges of revenue sources. *Id.*

16. *Id.* at 232. See, e.g., *State v. City of Miami*, 62 So. 2d 407, 407 (Fla. 1953) (constitution has no application in absence of direct or indirect pledge of ad valorem taxing power); *Chase v. City of Sanford*, 54 So. 2d 370, 374 (Fla. 1951) (bonds that constitute unconditional obligation of the city to repay require freeholder approval).

17. 159 So. 2d at 232. The court held that to determine whether a direct or indirect pledge of the taxing power exists, "the nature of the security issued and the covenants of the bond contract, rather than the name given to the security" are dispositive. *Id.*

18. See generally *Rose, Developments in Revenue Bond Financing*, 6 U. FLA. L. REV. 385 (1953).

19. See, e.g., *Klein v. City of New Smyrna Beach*, 152 So. 2d 466, 467 (Fla. 1963) (bonds secured by net revenues of proposed sewer system, cigarette taxes and special assessments).

20. See, e.g., *Welker v. State*, 93 So. 2d 591, 593 (Fla. 1957) (obligating excise taxes for bond payment indirectly burdened ad valorem taxes; no referendum required if indirect burden placed on ad valorem taxation).

21. 162 So. 2d 257 (Fla. 1964).

non-ad valorem revenues as bond collateral.<sup>22</sup> Previously, these funds had supported the town's general operating expenses. The Florida Supreme Court concluded that diversion of these funds from general expenses might require increased ad valorem taxation.<sup>23</sup> Nevertheless, the court held such an incidental effect on the taxing power did not require referendum approval.<sup>24</sup> Only bonded indebtedness directly pledging ad valorem taxation invoked the constitutional requirements. The supreme court reasoned that a contrary holding would necessitate referendum approval for all bonds secured by revenues that formerly supported general operating expenses.<sup>25</sup>

The court continued the trend of allowing pledges of non-ad valorem income sources in *State v. Tampa Sports Authority*.<sup>26</sup> The Authority pledged all legally available revenues, rather than specific sources of revenue, as bond security.<sup>27</sup> The Supreme Court of Florida affirmed validation after examining the bond resolution, the cooperation agreements, and the bonds themselves. The court determined the bonds were payable solely out of non-ad valorem revenues.<sup>28</sup> Additionally, the bondholders could not force ad valorem taxation, even in default. The constitutional restrictions therefore were not applicable.<sup>29</sup> Citing *Town of Medley*, the court held an incidental effect on the taxing power did not violate the constitution.<sup>30</sup>

The Florida Supreme Court's interpretation was approved in the 1968 constitutional revision of the local bonds' provision.<sup>31</sup> The court accordingly continued to uphold pledges of non-ad valorem tax revenues without referendum approval.<sup>32</sup> Nevertheless, the court remained sensitive to direct pledges

22. *Id.* Town pledged the proceeds of its cigarette tax, electric power franchise tax, utility taxes, and occupational license taxes in addition to revenues of the proposed water system. The bond agreements specifically provided that no ad valorem taxes were pledged directly or indirectly. *Id.*

23. *Id.* at 258.

24. *Id.* The court stated:

[T]he pledging of the special sources of revenue to retire the subject revenue bonds may require the Town of Medley to increase its ad valorem taxes in order to meet its operating expenses. Nevertheless, this does not require that the bonds be approved by freeholders vote since the ad valorem taxing power . . . is not directly pledged to the payment of the bonds.

*Id.*

25. *Id.*

26. 188 So. 2d 795 (Fla. 1966).

27. *Id.* at 796. The bonds were secured by revenues generated by the Authority and funds provided by cooperation agreements with the City of Tampa and Hillsborough County. The cooperation agreement specifically provided the monies given to the Authority would be from non-ad valorem sources. *Id.*

28. *Id.* at 797.

29. *Id.*

30. *Id.* at 797-98.

31. *State v. Miami Beach Redevelopment Agency*, 392 So. 2d 875, 898 (Fla. 1980). The revision specifically added the words "payable from ad valorem taxation." See FLA. CONST. art. VII, § 12 (1968).

32. See, e.g., *State v. Alachua County*, 335 So. 2d 554, 558 (Fla. 1976) (pledge of non-ad valorem revenues did not directly or indirectly pledge taxing power); *State v. Orange County*, 281 So. 2d 310, 311 (Fla. 1973) (nothing in 1968 constitution precludes issuance of revenue

of the taxing power.<sup>33</sup>

The instant case provided the court with an opportunity to clarify the constitutional requirements for indirect pledges of the taxing power. The court reaffirmed its *Town of Medley* holding, stating that more than an incidental effect on the taxing power was necessary to invalidate a bond issue.<sup>34</sup> The majority, however, distinguished the instant case on two grounds. First, the county attempted to pledge all legally available revenues rather than specific sources of revenue. Second, the covenant to fully maintain the revenue generating programs and services would inevitably require an ad valorem tax increase.<sup>35</sup> The court therefore concluded the bond issue would have had more than an incidental effect on the taxing power.<sup>36</sup>

While conceding the county had not specifically pledged ad valorem taxes, the court equated the security provisions and associated covenants with a direct pledge of the taxing power.<sup>37</sup> Citing *Halifax*, the majority concluded the bond issue would have a substantial impact on future ad valorem taxation. Thus, the constitution required an opportunity for taxpayers to vote on the bond issue.<sup>38</sup>

Citing *Tampa Sports Authority*, the three dissenting judges<sup>39</sup> noted the court had repeatedly validated pledges of non-ad valorem revenues without referendum approval, notwithstanding an incidental effect on the taxing power.<sup>40</sup> Additionally, *Halifax* was inapplicable because Volusia County had not specifically pledged ad valorem taxes.<sup>41</sup> The county retained authority to change the amount or rate of taxation as long as sufficient funds remained for bond repayment.<sup>42</sup> The bond covenants therefore were not a direct pledge of the taxing power.<sup>43</sup>

Although the instant case is a logical extension of the *Halifax* analysis, the

bonds payable from race track and jai alai funds without referendum approval); *State v. City of Miami Beach*, 234 So. 2d 103, 106 (Fla. 1970) (pledge of non-ad valorem revenues did not impose a general obligation on the taxing power).

33. See *State v. County of Dade*, 234 So. 2d 651, 653 (Fla. 1970). The court invalidated a statute allowing certificates of indebtedness secured by ad valorem tax revenues to be issued without freeholder approval. *Id.*

34. 417 So. 2d at 971.

35. *Id.* The court stated that maintaining "all of the programs that produce the revenues, while devoting the revenues themselves to the retirement of the bonds, will inevitably require that ad valorem taxes be increased so that the county will have sufficient operating revenues to maintain the programs and services that generate the pledged revenues." *Id.*

36. *Id.* at 972.

37. *Id.* The majority stated: "While the county has not directly pledged ad valorem taxes . . . its pledge of all other available revenues, together with its promise to do all things necessary to continue to receive the various revenues, will inevitably lead to higher ad valorem taxes . . . which amounts to the same thing." *Id.*

38. *Id.*

39. *Id.* at 972 (Alderman, J., dissenting). Justices Adkins and Overton joined Justice Alderman's dissent.

40. *Id.*

41. *Id.* at 973. The dissent stated: "Volusia County, unlike the Halifax Hospital District, had not expressly pledged ad valorem taxes to continue the operation of those governmental functions needed to generate the revenues to repay the bonds." *Id.*

42. *Id.* at 975.

43. *Id.* at 973.

court's rationale does not fully account for precedent.<sup>44</sup> The majority's factual distinction of *Town of Medley* is not consistent with *Tampa Sports Authority*, in which the court upheld a pledge of all legally available, non-ad valorem revenues for bond repayment.<sup>45</sup> Furthermore, the court fails to explain its finding that ad valorem taxation would inevitably, rather than possibly, be affected.<sup>46</sup> Finally, the court does not articulate the basis for equating the bond covenant's requirements with a direct pledge of the taxing power of the type invalidated in *Halifax*.<sup>47</sup>

Pursuant to *Halifax*, this bond issue's constitutionality depended upon analysis of the security issued and the covenants of the bond agreement.<sup>48</sup> In light of *Tampa Sports Authority*, pledging all legally available, unencumbered county revenues should not have subjected the bond issue to referendum. But the associated bond covenants, coupled with the pledged revenues, were sufficient to invoke the constitution.<sup>49</sup> Thus, in the majority's view, the bond's covenant must have been the crucial determinant of the issue's constitutionality.

To examine the constitutionality of this bond covenant, the majority adopted a substantial impact test.<sup>50</sup> If the bond covenant had a substantial impact on the exercise of ad valorem taxation, the constitution required a bond referendum. In applying this test, however, the court did not specifically discuss factors that would distinguish a substantial impact from an incidental effect on the taxing power.<sup>51</sup> Nor did the court state whether it examined the impact on existing county debt levels, economic conditions or capital projects.<sup>52</sup> Hence, the court failed to provide a uniform analytical framework for lower courts to apply the newly adopted test.

44. See *supra* notes 12-28 and accompanying text.

45. See *supra* notes 24 & 27.

46. See *supra* notes 24 & 36 and accompanying text.

47. 417 So. 2d at 972. The majority did not explicitly extend the reach of *Halifax*. Additionally, the majority failed to address the factual distinction between the instant case and *Halifax* as it had done with *Town of Medley*. The dissent, however, did discuss the factual distinction stating the county did not specifically pledge ad valorem taxes, nor could their exercise ever be compelled by the bondholders as found in *Halifax*. *Id.* at 973 (Alderman, J., dissenting).

48. See *supra* note 17 and accompanying text.

49. 417 So. 2d 971-72.

50. *Id.* at 972. The court found the bond covenants would have a "substantial impact" on the future exercise of the taxing power. Consequently, the court upheld the denial of validation for the bond issue. *Id.*

51. *Id.* The court simply stated a substantial impact on ad valorem taxation would result if the bond issue was validated. The majority did not promise an analysis or explanation of its statement. *Id.* See *Town of Medley*, 162 So. 2d at 258. If the ad valorem tax revenues were fully committed to the county's operating expenses prior to the proposed bond issuance, then a diversion of the revenues generated by the programs and services from the support of these activities would require a levy of the taxing power. This assumes, however, that support for these programs could not come from other revenue sources. *But cf.* *State v. City of Jacksonville*, 53 So. 2d 306, 308 (Fla. 1951) (upheld pledge of non-ad valorem revenues since city had sufficient unpledged revenues to support bond repayment).

52. Courts have examined a number of factors in addition to these mentioned in the text when determining the impact of a bond issue on the taxing power. See, e.g., *State v. Monroe County*, 81 So. 2d 522, 523 (Fla. 1951) (history of excess unpledged revenues).

The substantial impact test enunciated by the court reverses a trend of increased infringement on the public's exercise of ad valorem taxation.<sup>53</sup> This renewed sensitivity to the constitutional objective of public participation indicates judicial accord with the recent revolt against increasing tax burdens.<sup>54</sup> Although this test does not prevent ad valorem tax pledges, it does limit the flexibility of their use in municipal financing plans. Consequently, local government capital structures will change due to the restrictions placed on bonds affecting ad valorem taxation.<sup>55</sup> The degree to which municipal financing techniques will be affected, however, depends on the composition of the municipality's revenue base<sup>56</sup> and the longevity of the recent bond market collapse.<sup>57</sup>

Although this decision may place some local governments in a financial bind, the denial of bond validation in the instant case is not troubling. The majority's substantial impact test properly sets judicial focus on the underlying economic consequences of a bond issue. This judicial standard provides taxpayers with a greater voice in the commitment of their tax dollars to capital projects. Thus, the holding comports with constitutional intent. The court's failure to distinguish the crucial elements of substantial impact in a bond validation case unfortunately limits consistent application of the *Halifax* analysis. Furthermore, the presence of a strong dissent may confine the standard's application to only gross infringements on the exercise of the taxing power. The lower courts may look to the spirit of the substantial impact test, rather than its initial shortcomings, and thereby realize the constitutional intent.

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53. *E.g.*, *Tucker v. Underdown*, 356 So. 2d 251, 253-54 (Fla. 1978) (use of ad valorem revenues for bond repayment did not violate constitution since taxing was not pledged nor could it be compelled by bondholders).

54. *See Rankin, Osburn & Rogers, Municipal Bonds and Property Tax Limitations*, 9 ENVTL. L. 453, 453-54 (1979) (by the time general election was held for Proposition 13, 16 other states had various forms of tax or expenditure limitations on ballots); Schilling, Griggs & Ebert, *Wisconsin Municipal Debt Finance: An Outlook for the Eighties*, 63 MARQ. L. REV. 540, 540-41 (1980) (passage of Proposition 13 in California epitomized an increasing mood against tax increases) [hereinafter cited as Schilling].

55. *See Schilling, supra* note 54, at 540-44. A local government's capital structure is comprised of general obligation borrowings, revenue bond financing, incremental tax financing and the possibility of industrial revenue development bonds. A decrease in funds supplied by one capital structure component must be made up, if possible, by an increase in another component. Thus, if general obligation borrowings are restricted, the composition of the capital structure must change. *Id.*

56. *See Rankin, Osburn & Rogers, supra* note 54, at 458 (ad valorem property taxes are largest source of local government revenues).

57. *See Schilling, supra* note 54, at 540-41 (collapse of bond market in early 1980 had a devastating effect on municipalities).